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Scotia Covenants 11th Annual Report 1974



## Business of the Company

Scotia Covenants is a mortgage-lending company that is sponsored and owned by The Bank of Nova Scotia and several large Canadian corporations, all of which are represented on the Board of Directors. It is regulated and supervised by the Federal Department of Insurance under the Investment Companies Act of Canada.

Mortgages are made on residential, commercial and industrial properties throughout Canada. The mortgage loans are insured by The Mortgage Insurance Company of Canada or by the Federal Government or a Provincial Government.

Scotia Covenants issues short term promissory notes and term notes at attractive interest rates. The short term notes have a term of 1 to 365 days and a minimum amount of \$50,000. The term notes have a term of 1 to 10 years and a minimum amount of \$1,000.

The notes are direct senior obligations of the Company and qualify as authorized investments for insurance companies, loan and trust companies and pension funds. They represent a prime investment for individuals and corporations.



## Scotia Covenants Is the New Name For Central Covenants

In March 1975, Central Covenants (Holdings) Limited changed its name to Scotia Covenants Limited (Les Covenants Scotia Limitée). The purpose of the change was to more closely identify the Company as an affiliate of The Bank of Nova Scotia.

No changes in the Company's operations or shareholdings are to take place as a result of this name change. The Company will continue its policy of making direct mortgage loans which was established in 1971 when The Bank of Nova Scotia increased its equity interest to 50%. Prior to 1970 the Company participated in joint high ratio loans with institutional lenders. The change in name will increase the Company's marketing capabilities in selling its services to the public.

There is to be no change in the name of the Company's mortgage lending subsidiary, Central Covenants Limited.



## SCOTIA COVENANTS LIMITED

### Financial Highlights

|                                             | 1974          | 1973         |
|---------------------------------------------|---------------|--------------|
| <b>Operations</b>                           |               |              |
| Income . . . . .                            | \$ 10,201,584 | \$ 6,452,354 |
| Expenses . . . . .                          | 9,143,275     | 5,396,585    |
| Income taxes . . . . .                      | 549,000       | 534,000      |
| Net earnings . . . . .                      | 509,309       | 521,769      |
| <b>Per Share</b>                            |               |              |
| Net earnings . . . . .                      | \$ 1.57       | \$ 2.10      |
| Dividends . . . . .                         | 1.05          | 1.05         |
| Book value . . . . .                        | 17.43         | 16.74        |
| <b>Mortgages</b>                            |               |              |
| Balance outstanding . . . . .               | \$119,830,788 | \$81,597,146 |
| <b>Credit Extended to the Company</b>       |               |              |
| Total bank lines . . . . .                  | \$ 30,000,000 | \$12,000,000 |
| Bank lines in use . . . . .                 | —             | —            |
| Short-term notes outstanding . . . . .      | 21,332,071    | 3,924,359    |
| Term notes outstanding . . . . .            | 78,894,828    | 62,656,374   |
| Long-term debentures . . . . .              | 11,944,000    | 12,140,000   |
| Long-term subordinated debentures . . . . . | 2,080,000     | 2,129,000    |
| <b>Capital</b>                              |               |              |
| Common shares . . . . .                     | \$ 5,118,121  | \$ 3,661,225 |
| Retained earnings . . . . .                 | 1,437,136     | 1,284,937    |
| Total . . . . .                             | 6,555,257     | 4,946,162    |

# SCOTIA COVENANTS LIMITED

## Directors

T. R. ALTON  
President and General Manager  
Scotia Covenants Limited  
Toronto, Ontario

W. J. ASH  
Portfolio Manager  
The Bank of Nova Scotia  
Toronto, Ontario

G. R. BLAKE  
Vice-President and Treasurer  
The Equitable Life Insurance Company of Canada  
Waterloo, Ontario

W. E. BAILEY  
General Manager, Canadian Operations  
The Bank of Nova Scotia  
Toronto, Ontario

J. E. BROOKES  
Vice-Chairman  
Greenshields Incorporated  
Montreal, Quebec

D. H. COCHRANE  
Vice-President, Administration and General  
Manager  
The Eastern Canada Savings and Loan Company  
Halifax, Nova Scotia

B. A. ENNIS  
General Manager, Corporate Credit  
The Bank of Nova Scotia  
Toronto, Ontario

M. T. GERECKE  
Financial Vice-President, Real Estate  
The Canada Life Assurance Company  
Toronto, Ontario

D. M. HAINES  
Assistant Vice President, Property Investments  
Confederation Life Insurance Company  
Toronto, Ontario

G. C. HITCHMAN  
Deputy Chairman  
The Bank of Nova Scotia  
Toronto, Ontario

R. M. MacINTOSH  
Executive Vice-President  
The Bank of Nova Scotia  
Toronto, Ontario

R. L. MASON  
Assistant General Manager, Investments  
The Bank of Nova Scotia  
Toronto, Ontario

J. H. McMEEKIN  
Treasurer  
The Imperial Life Assurance Company of Canada  
Toronto, Ontario

L. D. McMURRAY  
President  
Investors Syndicate Realty Limited  
Winnipeg, Manitoba

M. P. PRESCOTT  
Associate Treasurer  
Sun Life Assurance Company of Canada  
Montreal, Quebec

P. E. REINHARDT  
Vice-President, Finance  
Industrial Life Insurance Company  
Quebec City, Quebec

T. F. D. SIMMONS  
Treasurer  
Alcan Aluminium Limited  
Montreal, Quebec

## Officers

R. M. MacINTOSH  
Chairman of the Board

G. C. HITCHMAN  
Deputy Chairman of the Board

T. R. ALTON  
President and General Manager

J. P. McAVOY  
Vice-President

R. C. BROWN  
Secretary

F. KOZYSTKO  
Treasurer and Assistant Secretary

M. A. SIMOURD  
Assistant Treasurer

## President's Report to the Shareholders

1974 was a year of substantial growth in the assets of Scotia Covenants but a year of decline in the level of profits. Assets rose \$36 million or 41% to \$123 million at the year end but earnings per share declined 25% to \$1.57 per share.

It was an extraordinary year for all mortgage lenders with the unprecedented rise in the cost of borrowed funds in the Spring of 1974. As an example, we started the year with a cost of short term funds of 8¼% and by August, this had peaked at about 11¼%. Similarly, interest rates on term notes at the beginning of the year was 9% and this rose to a peak of 11% by October 1974.

Our policy in the past has been to fix the mortgage rate of interest at the time the loan is committed or approved; however, there can be considerable delay from the date of commitment to the date of funding particularly in new construction. In 1974, we therefore found ourselves in the position of funding mortgages when our borrowing costs exceeded the mortgage rate and we had in effect a negative spread. As a consequence of these events, we have changed our policy from one of fixing the interest rate at the time the mortgage is committed to one of fixing the interest rate closer to the time of the actual funding based on an interest spread over our five year borrowing rate. This policy will give us protection of our interest spread in a rising interest market and will give protection to borrowers on a falling interest market.

Interest rates have shown a marked decline late in 1974 and early in 1975 in response to the soft economies of the major countries of the world. Scotia Covenants' outlook in 1975 is one of slower asset growth because of a reduced demand for mortgage credit but one of increased level of earnings as a result of lower borrowing costs and improved interest spreads.

The federal budget in November included a 10% surcharge on corporate profits for one year beginning May 1, 1974. This had the effect of reducing our 1974 earnings by 5¢ a share. The Company's average tax rate has increased from 48.1% in 1972, to 50.6% in 1973 and 51.9% in 1974. This represents an overall increase in our tax rate since 1972 of 3.8%.

On April 30, 1974, 42,699 shares were issued for cash of \$781,392 representing the balance of shares issued under the 1973 rights offering.

The Company in May successfully completed a 1974 rights offering, which was fully subscribed. Shareholders agreed to purchase an additional 173,148 shares for a total consideration of \$3,116,664. Out of this subscription, 36,728 shares were issued for \$661,104 on July 31, 1974 and the balance of the subscription of 136,420 shares for \$2,455,560 will be issued as required by the Company in its 1975 fiscal year.

The Company's lines of credit with Canadian banks were increased to \$30 million. The increased lines of credit and the additional equity capital place the



Company in a strong financial position for continued growth.

At the annual meeting, Mr. Thomas A. Boyles, Chairman of our Board for many years, retired, as a result of his retirement as Chairman of the Board of The Bank of Nova Scotia. Earlier in the year, Mr. William J. Reid, after more than eight years, retired from the Board as a result of new corporate responsibilities on being appointed Vice-President, Finance, of Alcan Ore Limited. Both these men provided valuable counsel and advice to the Company and we appreciate their contribution.

These vacancies on the Board have been filled by Mr. William E. Bailey, General Manager, Canadian Operations of The Bank of Nova Scotia, and Mr. T. F. Denys Simmons, Treasurer of Alcan Aluminium Limited. We welcome both these men to our Board.

In closing, I would like to thank the Board for their support and encouragement and to express appreciation to our employees for their loyalty and diligence during the past year.

April 20, 1975

T. R. ALTON  
President

# Consolidated Statement of Earnings

For the Year Ended October 31, 1974

|                                                                      | 1974<br>\$        | 1973<br>\$       |
|----------------------------------------------------------------------|-------------------|------------------|
| <b>Income</b>                                                        |                   |                  |
| Interest—                                                            |                   |                  |
| Mortgages . . . . .                                                  | 9,666,465         | 6,021,674        |
| Short-term investments . . . . .                                     | 286,645           | 290,099          |
| Gain on redemption of debt . . . . .                                 | 47,231            | 44,007           |
| Leasing income . . . . .                                             | 54,925            | 23,680           |
| Other . . . . .                                                      | 146,318           | 72,894           |
|                                                                      | <u>10,201,584</u> | <u>6,452,354</u> |
| <b>Expenses</b>                                                      |                   |                  |
| Interest—                                                            |                   |                  |
| Debentures . . . . .                                                 | 975,123           | 1,005,711        |
| Term notes . . . . .                                                 | 5,658,718         | 3,358,592        |
| Bank advances . . . . .                                              | 18,971            | 7,936            |
| Short-term promissory notes . . . . .                                | 1,543,882         | 383,120          |
| Amortization of debt discount and expense (note 2) . . . . .         | 182,247           | 132,450          |
| Trustees' fees for debentures . . . . .                              | 8,176             | 7,991            |
| Bank charges . . . . .                                               | 53,914            | 33,825           |
| Short-term promissory note expense . . . . .                         | 36,915            | 16,254           |
| Mortgage servicing fees . . . . .                                    | 315,534           | 204,372          |
| Remuneration of officers (note 9) . . . . .                          | 69,166            | 58,175           |
| Salaries . . . . .                                                   | 54,180            | 28,896           |
| Office and general . . . . .                                         | 75,253            | 68,416           |
| Legal and audit . . . . .                                            | 14,706            | 21,362           |
| Capital and place of business taxes . . . . .                        | 110,654           | 46,089           |
| Rent . . . . .                                                       | 17,518            | 14,547           |
| Directors' fees (note 9) . . . . .                                   | 8,318             | 8,849            |
|                                                                      | <u>9,143,275</u>  | <u>5,396,585</u> |
| <b>Earnings Before Income Taxes</b> . . . . .                        | <u>1,058,309</u>  | <u>1,055,769</u> |
| <b>Provision For Income Taxes</b>                                    |                   |                  |
| Current . . . . .                                                    | 241,700           | 191,700          |
| Deferred . . . . .                                                   | 307,300           | 342,300          |
|                                                                      | <u>549,000</u>    | <u>534,000</u>   |
| <b>Net Earnings For the Year</b> . . . . .                           | <u>509,309</u>    | <u>521,769</u>   |
| <b>Earnings Per Share (note 7)</b> . . . . .                         | <u>\$1.57</u>     | <u>\$2.10</u>    |
| <b>Weighted Average Daily Number of Shares Outstanding</b> . . . . . | <u>327,190</u>    | <u>248,370</u>   |

# Consolidated Balance Sheet

As at October 31, 1974

## Assets

|                                                                                               | 1974<br>\$         | 1973<br>\$        |
|-----------------------------------------------------------------------------------------------|--------------------|-------------------|
| Cash . . . . .                                                                                | 174,516            | 86,996            |
| Short-term investments—at cost, plus accrued interest,<br>which approximates market . . . . . | 2,204,989          | 4,401,210         |
| Insured mortgage loans—at amortized cost, plus interest<br>due and accrued . . . . .          | 119,830,788        | 81,597,146        |
| Due from parent company . . . . .                                                             | 4,150              | 7,652             |
| Lease receivable . . . . .                                                                    | 546,305            | 642,376           |
| Income taxes recoverable . . . . .                                                            | —                  | 85,803            |
| Deferred charges (note 2)—<br>Unamortized debt discount and expense . . . . .                 | 635,148            | 618,034           |
|                                                                                               | <u>123,395,896</u> | <u>87,439,217</u> |

Signed on behalf of the Board,

"T. R. ALTON", Director

"R. M. MacINTOSH", Director



## Liabilities

|                                                 | 1974<br>\$         | 1973<br>\$        |
|-------------------------------------------------|--------------------|-------------------|
| Accounts payable and accrued interest . . . . . | 1,671,439          | 1,084,922         |
| Income taxes payable . . . . .                  | 52,601             | —                 |
| Short-term promissory notes . . . . .           | 21,332,071         | 3,924,359         |
| Term notes (note 3) . . . . .                   | 78,894,828         | 62,656,374        |
| Sinking fund debentures (note 4) . . . . .      | 11,944,000         | 12,140,000        |
|                                                 | <u>113,894,939</u> | <u>79,805,655</u> |
| Subordinated debentures (note 5) . . . . .      | 2,080,000          | 2,129,000         |
| Deferred income taxes (note 6) . . . . .        | 865,700            | 558,400           |
|                                                 | <u>116,840,639</u> | <u>82,493,055</u> |

## Shareholders' Equity

### Capital stock (note 7)

Authorized—

1,000,000 shares without nominal or par value

Issued and fully paid—

376,025 shares (1973—295,398 shares)

Retained earnings

|                    |                   |
|--------------------|-------------------|
| 5,118,121          | 3,661,225         |
| 1,437,136          | 1,284,937         |
| <u>6,555,257</u>   | <u>4,946,162</u>  |
| <u>123,395,896</u> | <u>87,439,217</u> |

# Consolidated Statement of Retained Earnings

For the Year Ended October 31, 1974

|                                                            | 1974<br>\$       | 1973<br>\$       |
|------------------------------------------------------------|------------------|------------------|
| <b>Retained Earnings – Beginning of Year</b>               |                  |                  |
| As previously reported . . . . .                           | 659,337          | 767,736          |
| Adjustment for general mortgage reserve (note 8) . . . . . | 625,600          | 267,600          |
| As restated . . . . .                                      | 1,284,937        | 1,035,336        |
| Net earnings for the year . . . . .                        | 509,309          | 521,769          |
|                                                            | 1,794,246        | 1,557,105        |
| Dividends . . . . .                                        | 357,110          | 272,168          |
| <b>Retained Earnings – End of Year . . . . .</b>           | <u>1,437,136</u> | <u>1,284,937</u> |

## Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Central Covenants (Holdings) Limited and its subsidiary as at October 31, 1974 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the companies as at October 31, 1974 and the results of their operations and the changes in their financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

November 14, 1974

COOPERS & LYBRAND,  
Chartered Accountants



# Consolidated Statement of Changes in Financial Position

For the Year Ended October 31, 1974

|                                                           | 1974<br>\$        | 1973<br>\$        |
|-----------------------------------------------------------|-------------------|-------------------|
| <b>Source of Funds</b>                                    |                   |                   |
| Net earnings . . . . .                                    | 509,309           | 521,769           |
| Items not requiring an outlay of funds—                   |                   |                   |
| Amortization of deferred expenses . . . . .               | 182,247           | 132,450           |
| Deferred income taxes . . . . .                           | 307,300           | 342,300           |
| Funds provided from operations . . . . .                  | 998,856           | 996,519           |
| Net increase in short-term promissory notes . . . . .     | 17,407,712        | 360,359           |
| Net increase in term notes . . . . .                      | 16,238,454        | 32,002,852        |
| Increase in other liabilities—net . . . . .               | 639,118           | 384,934           |
| Decrease in lease receivable . . . . .                    | 96,071            | —                 |
| Net decrease in cash and short-term investments . . . . . | 2,108,701         | —                 |
| Issue of shares . . . . .                                 | 1,456,896         | 1,309,800         |
|                                                           | <u>38,945,808</u> | <u>35,054,464</u> |

## Application of Funds

|                                                           |                   |                   |
|-----------------------------------------------------------|-------------------|-------------------|
| Increase in other assets—net . . . . .                    | 110,056           | 349,582           |
| Lease receivable . . . . .                                | —                 | 642,376           |
| Redemption and repayment of—                              |                   |                   |
| Sinking fund debentures . . . . .                         | 196,000           | 273,000           |
| Subordinated debentures . . . . .                         | 49,000            | 50,000            |
| Dividends . . . . .                                       | 357,110           | 272,168           |
| Net increase in cash and short-term investments . . . . . | —                 | 3,134,877         |
|                                                           | <u>712,166</u>    | <u>4,722,003</u>  |
| <b>Increase in Insured Mortgage Loans . . . . .</b>       | <u>38,233,642</u> | <u>30,332,461</u> |

# Notes to Consolidated Financial Statements

For the Year Ended October 31, 1974

## 1. Consolidation

The consolidated financial statements include the accounts of Central Covenants Limited, a wholly-owned subsidiary.

## 2. Deferred Charges

Debt discount and expense are amortized on a straight-line basis over the original outstanding term of the related debt.

## 3. Term Notes

The average interest cost on outstanding term notes for the year was 8.39%. Term notes are due as follows:

| Year ending October 31, | 1974<br>\$        | 1973<br>\$        |
|-------------------------|-------------------|-------------------|
| 1974 . . . . .          | —                 | 4,178,400         |
| 1975 . . . . .          | 8,817,101         | 8,427,974         |
| 1976 . . . . .          | 19,276,000        | 17,118,000        |
| 1977 . . . . .          | 19,864,685        | 16,814,000        |
| 1978 . . . . .          | 17,022,042        | 15,589,000        |
| 1979 . . . . .          | 11,439,000        | 234,000           |
| 1980 . . . . .          | 877,000           | 3,000             |
| 1981 . . . . .          | 134,000           | 37,000            |
| 1982 . . . . .          | 90,000            | —                 |
| 1983 . . . . .          | 346,000           | 255,000           |
| 1984 . . . . .          | 1,029,000         | —                 |
|                         | <u>78,894,828</u> | <u>62,656,374</u> |

## 4. Sinking Fund Debentures

The sinking fund debentures consist of:

|                                          | 1974<br>\$        | 1973<br>\$        |
|------------------------------------------|-------------------|-------------------|
| 5½% Series A due March 1, 1985 . . . . . | 4,185,000         | 4,185,000         |
| 6¼% due September 1, 1990 . . . . .      | 4,610,000         | 4,720,000         |
| 7¼% due February 15, 1977 . . . . .      | 816,000           | 847,000           |
| 7¼% due February 15, 1982 . . . . .      | 2,333,000         | 2,388,000         |
|                                          | <u>11,944,000</u> | <u>12,140,000</u> |

The sinking fund debentures are redeemable in compliance with covenants of the relevant trust deeds.



The sinking fund provisions of the trust deeds relating to debentures require the following payments during the next five years :

|                | \$        |
|----------------|-----------|
| 1975 . . . . . | 149,000   |
| 1976 . . . . . | 385,000   |
| 1977 . . . . . | 1,160,000 |
| 1978 . . . . . | 445,000   |
| 1979 . . . . . | 445,000   |

#### 5. Subordinated Debentures

The 8% subordinated debentures due May 15, 1983 are subordinated to other sinking fund debentures, term notes and short-term promissory notes and bank borrowings. In addition to the fixed rate of interest of 8%, participating interest of 2% for a full year is payable on May 15, 1975. The debentures are redeemable at the option of the company at any time prior to maturity at annually reducing premiums. The debentures are not redeemable prior to maturity for the purpose of refunding at an interest rate of less than 10%.

#### 6. Deferred Income Taxes

Income taxes otherwise payable, relating to the period from incorporation to October 31, 1968, have been deferred in the amount of \$364,200 by claiming, for tax purposes, debt expenses in excess of amounts charged against earnings, and a mortgage reserve. This amount has not been set up in the accounts.

#### 7. Capital Stock

By supplementary letters patent dated July 8, 1974, the maximum aggregate consideration of the authorized 1,000,000 shares without nominal or par value was increased from \$5,000,000 to \$15,000,000.

During the year the company issued 80,627 shares for a cash consideration of \$1,456,896.

Shareholders have subscribed for an additional 136,420 shares to be issued as required by the company for a cash consideration of \$2,455,560 on or before October 31, 1975.

If it were assumed that the 136,420 shares had been issued on April 16, 1974, the earnings per share would have been \$1.43. In calculating the diluted earnings per share the assumption is made that the funds derived from the issue of shares had been invested to produce an annual rate of 10% before applicable income taxes. The amount of income imputed after taxes was \$63,700.

#### 8. General Mortgage Reserve

An adjustment has been made in the 1973 financial statements to give retroactive effect to the reclassification of general mortgage reserve to retained earnings.

#### 9. Directors and Officers

The company has seventeen directors and six officers. Three of the officers are also directors.

#### 10. Foreign Exchange

The company's liabilities include \$1,000,000 payable in United States currency which have been recorded on the balance sheet as \$1,010,101 Canadian dollars which is the amount required to purchase \$1,000,000 United States currency under a foreign exchange contract with a Canadian chartered bank.

